Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Cogdill | Analyst: Kristina E. North | Bill Number: AB 484

Related Bills: See Prior Analysis | Telephone: 845-6978 | Amended Date: April 21, 2003

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: Minimum Franchise Tax/Exempts Corporations With Gross Receipts Less Than $1,000,000, Less Than 50 Employees & Incurs Net Operating Loss

____	DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ______________________.
X	AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
X	AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced February 14, 2003.
X	FURTHER AMENDMENTS NECESSARY.
____	DEPARTMENT POSITION CHANGED TO ______________________.
X	REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED FEBRUARY 14, 2003, STILL APPLIES.
X	OTHER - See comments below.

SUMMARY

This bill would exempt certain corporations from the minimum franchise tax (MFT).

SUMMARY OF AMENDMENTS

The April 21, 2003, amendment would exempt a corporation from the MFT to the extent the MFT exceeds the amount of the taxpayer's net operating loss (NOL) for the taxable year. To qualify for this exemption, the corporation must:

- have gross receipts, less returns and allowances, of less than $1 million;
- employ 50 or less full-time equivalent employees; and
- incur an NOL.

The amendments removed the requirement that one member of the Commission on Tax Policy and the New Economy be a small business owner.

The April 21, 2003, replaced the term "realizes no profit" with "gross receipts, less returns and allowances." This change resolved the implementation consideration discussing the lack of definition for "realizes no profit." The new, revised, and remaining implementation considerations and a new revenue estimate are included below. The remainder of the department's analysis of the bill as introduced February 14, 2003, still applies.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP	Jana Howard for Brian Putler	5/15/03
____ SA	____ O	____ NAR		
____ N	____ OUA	X PENDING		

POSITION

Pending.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

As a result of the April 22, 2003, amendment, the following new concerns have been identified:

- It is unclear how "full-time equivalent" would be determined. For example, one or more part-time employees could be considered a full-time equivalent employee.
- Corporations must currently pay quarterly estimated tax payments, the first of which must be at least equal to the MFT. Assuming the required minimum first quarter estimate payment had not been paid and estimate penalties were applied, the department would not have the authority to later abate the penalties.
- A taxpayer does not incur an NOL during a year. Instead a taxpayer incurs an operating loss that is treated as a "net operating loss" with respect to **other** taxable years, but **not** the year in which it is actually incurred. It is recommended that the bill be modified to provide that the taxpayer has incurred an "operating loss" for the taxable year.
- It is unclear whether the MFT exemption should be determined **before** OR **after** application of NOL carryovers from prior years that may result in a profitable year becoming a year in which the taxpayer has a net loss.

In the previously submitted implementation concerns that are re-stated below, underscoring identifies a change to one of the concerns.

- Under existing law, every corporation is required to pay estimated tax for the taxable year. These payments are made in four installments, but the amount of the first installment must be at least equal to the MFT. Since a corporation would not know its eligibility for the MFT exemption proposed by this bill until the end of the year, it would be required to pay an amount equal to the MFT. Assuming a corporation was eligible for this bill's proposed MFT exemption, it would be entitled to a refund the when the return is filed.
- This bill uses the term "gross receipts, less returns and allowances," however, no definition is provided. The reduced MFT that applied to new corporations for the 1999 taxable year used and defined the phrase "gross receipts, less returns and allowances *reportable to the state*." Since this bill uses a similar, but not identical phrase, a definition should be included in this bill for clarity and to avoid disputes between taxpayers and the department. <u>Without clarification, the department could interpret the "gross receipts, less returns and allowances" to mean income from all sources.</u>

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Revenue Impact ($ Millions)			
Fiscal Year	2003/04	2004/05	2005/06
Revenue Loss	-195	-125	-135

This bill does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

In the first fiscal year 2003/04, the impact is higher due to the doubling up effect for calendar year filers with minimum payments due in April of each tax year. Doubling up means that there are two April 15 payments affected in the first fiscal year (2003/04). If this bill is enacted, minimum tax payments made in April 2003 would have to be refunded, and no minimum tax would be paid in April 2004 for the same taxpayer. Thus, the minimum tax payments that would have been paid for two tax years would have an impact in the first fiscal year.

These estimates take into account the more than 8,000 taxpayers whose MFT minimum tax exceed the net operating loss, and would therefore pay a minimum tax to the extent it exceeds net operating loss. The amount of minimum tax that exceeds the NOL in 2001, and would be revenue to the state, was more than $3 million. The revenue estimates above also took into account data from the Employment Development Department that showed that 95% of all businesses have fewer than 50 employees.

The total number of qualifying taxpayers was reduced in this amendment to account for those businesses with fewer than 50 employees (145,000 taxpayers times 95% equals 138,000 taxpayers).

In addition, the number of qualifying taxpayers was reduced by the more than 8,000 taxpayers who would still be required to pay some minimum tax, to the extent their minimum tax exceeded net operating loss (138,000 taxpayers minus 8,000 equals 130,000 taxpayers). The number of qualifying taxpayers was grown out at an annual 5% rate to 2003 (from 130,000 in 2001 to 144,000 in 2003), and then fiscalized for the final revenue loss impact.

The number of qualifying corporate taxpayers is estimated to be 144,000 in 2003. The number was broken out into calendar and fiscal filers (a 65/35 split – 144,000 times 65% equals 94,000 returns; 144,000 times 35% equals 50,000 returns). Each group of filers was multiplied by the minimum tax of $800 (94,000 calendar filers times $800 equals $75 million; 50,000 fiscal filers times $800 equals $40 million).

For 2003/2004, the revenue impact from calendar filers is estimated to be -$75 million in 2003, and -$79 million in 2004. These amounts are added to the revenue impact from fiscal filers for 2003 of -$40 million for a total 2003/2004 impact rounded to -$195 million. The 2004/2005 fiscal year is the total of calendar filers 2005 impact of -$84 million with fiscal filers 2004 impact of -$43 million for a rounded total of -$125 million. The 2005/2006 revenue impact is the total of calendar filers 2006 impact of -$88 million and the fiscal filers 2005 impact of -$45 million, for a rounded impact of -$135 million.

Additionally, newly available date from tax year 2001 was used to prepare this estimate.

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